COMMONWEALTH OF KENTUCKY
SUPREME COURT OF KENTUCKY
CASE NO. 2015-SC-000178-D & 2015-SC-000181-D, CONSOLIDATED

KENTUCKY CATV ASSOCIATION, INC., et al. APPELLANTS

v.

ON REVIEW FROM KENTUCKY COURT OF APPEALS
CASE NO. 13-CA-001112
FRANKLIN CIRCUIT COURT NO. 11-CI-01418

CITY OF FLORENCE, KENTUCKY, et al., APPELLEES

BRIEF OF APPELLEES

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that this Brief was served via regular mail on this 10th day of June, 2016 on: Judge Phillip J. Shepherd, Franklin Circuit Court, Division I, 222 St. Clair St., Frankfort, KY 40601; Samuel P. Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 40601; Bethany Atkins Rice, Office of Legal Services for Revenue, P.O. Box 423, Frankfort, KY 40602-0423; Timothy J. Eifler, Douglas F. Brent, and Jackson W. White, Stoll Keenon Ogden, PLLC, 500 W. Jefferson St., Ste. 2000, Louisville, KY 40202; Eric S. Tresh and Maria Torodova, Sutherland Asbill & Brennan, LLP, 999 Peachtree St., NE, Atlanta, GA 30309-3996; John Nalbandian, Taft Stettinius & Hollister LLP, 425 Walnut St., Ste. 1800, Cincinnati, OH 45202-3957; Gardner F. Gillespie and J. Aaron George, Sheppard Mullin Richter & Hamilton LLP, 2099 Pennsylvania Ave., N.W., Suite 100, Washington, D.C. 20006-6901.

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STATEMENT CONCERNING ORAL ARGUMENT

Appellees City of Florence, Kentucky; City of Winchester, Kentucky; City of Greensburg, Kentucky; City of Mayfield, Kentucky; and Kentucky League of Cities, Inc. ("KLC") (collectively, "Appellees" or the "Cities"),[1] respectfully request oral argument. This appeal involves complicated constitutional questions that have an important impact on local governments in Kentucky and, in particular, significant financial implications for those local governments. Oral argument will assist the Court in fully understanding these constitutional issues and their implications.

[1] Appellee cities are municipal corporations organized and existing under the Constitution and laws of the Commonwealth of Kentucky, and KLC is a Kentucky non-profit corporation representing all of its member cities throughout the Commonwealth and pursuing this case on their behalf.

COUNTERSTATEMENT OF POINTS AND AUTHORITIES

COUNTERSTATEMENT OF THE CASE[2]

I. Overview

The General Assembly concocted a novel tax scheme in 2005 that took away constitutional rights the framers gave to Kentucky cities in 1891: the rights to levy and collect franchise fees for public utility franchises in exchange for the utility's use of the cities' streets and rights-of-way. To defend the scheme, Appellants try to write out of the Kentucky Constitution the requirement that cities must award franchises to the "highest and best bidder," arguing that this does not actually mean that the cities get to collect monetary payments for the grant of their franchises. They dismiss a century of case law discussing the rights granted to cities as including the right to "sell" a utility franchise for the "greatest price possible" and claim that the constitutional rights the cities exercised for over 100 years are not really in the constitution. And they posit that it is more important for cable television providers to be on better financial footing vis-à-vis satellite television providers than it is for Kentucky cities to fulfill their constitutional duty to their citizens to obtain the "highest and best" value from public utility franchisees. Appellants offer an absurd reading of the Kentucky Constitution to continue a tax scheme that has been an economic boondoggle for Appellants and an epic disaster for Kentucky cities—and, if Appellants succeed here, the cities' shortfalls could get even worse.

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[2] Appellees do not accept Appellants' Statements of the Case in their respective briefs. Appellants are Lori Hudson Flanery (in her official capacity as Secretary of the Finance and Administration Cabinet, Commonwealth of Kentucky) and Thomas B. Miller (in his official capacity as Commissioner of the Department of Revenue, Finance and Administration Cabinet, Commonwealth of Kentucky) (collectively, the "Cabinet"). The Cabinet filed "The Finance and Administration Cabinet's Brief" (hereafter, "Cab. Br."). Appellant-Intervenor Kentucky CATV Association, Inc. ("KCTA") is a trade group for cable television providers. KCTA filed the "Brief of Appellant, Kentucky CATV Association, Inc. (hereafter, "KCTA Br.").

But a Kentucky statute that violates the Kentucky Constitution is void. *See* Ky. Const. § 26. In its decision below, a unanimous panel of the Kentucky Court of Appeals applied this well-established rule, protecting rights granted to Kentucky cities in §§ 163 and 164 of the Kentucky Constitution and concluding that the Multichannel Video Programming and Communications Services Tax (codified at KRS §§ 136.600 to 136.660, the "Telecom Tax") is unconstitutional to the extent it violates those rights. (*See* Court of Appeals' Opinion Reversing and Remanding (hereinafter, the "Opinion"), attached as Appendix 1). The court validated the "highest and best bidder" requirement in the constitution for the award of city utility franchises, explaining that "[t]hrough enactment of Section 164, the drafters of our Constitution envisioned that local governments would receive valuable consideration in exchange for the granting of the utility franchises." (*Id.* at 7). And, when stating that "[t]he Commonwealth may not by legislative fiat abrogate appellants' constitutionally delegated prerogative to grant a franchise and collect franchise fees" (*id.* at 8), the court honored the principle that the Kentucky Constitution is "the supreme law of this Commonwealth to which all acts of the legislature, the judiciary and any government agent are subordinate." *Kuprion v. Fitzgerald*, 888 S.W.2d 679, 681 (Ky. 1994).

The Kentucky Court of Appeals correctly recognized that the framers thought it so important to protect cities' valuable franchise rights that they (1) delegated those rights to the cities in the constitution, and (2) insulated those rights from corruption by imposing a "highest and best" bidding process to ensure that Kentucky cities would collect compensation for their citizens. That bidding requirement to prevent undue influence in franchising matters was prescient, as interested parties certainly seek to

influence the lawmakers who now control the distribution of Telecom Tax funds. In fact, Appellant KCTA, a trade association for cable companies, has lobbied the General Assembly to the tune of $860,111.10 in total expenses from 2005 (when the Telecom Tax was passed) to today. (*See* Employer Expense Summaries and Details for "KY Cable Telecommunications Assn." available at http://klec.ky.gov, attached as Appendix 2).[3] If Appellants prevail, nothing will prevent the General Assembly from freely amending the Telecom Tax statute at any time to reduce or eliminate any and all future distributions to the Cities. In other words, whether cities receive *any* funds for their franchises will be up to the General Assembly as influenced by lobbying groups, an outcome that offends the letter and spirit of the Kentucky Constitution.

Contrary to Appellants' alarmist assertions, affirming the decision below and returning certain participants in a tax scheme to *status quo ante* will not create chaos. Further, their dire prophecies about what they speculate could happen if this Court affirms the Court of Appeals' ruling are irrelevant to whether the Telecom Tax violates the Cities' constitutional rights. Indeed, Kentucky courts have struck down tax schemes and issued historic rulings affecting the Commonwealth in the past to uphold constitutional rights, and the Commonwealth has survived.

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[3] Expenses include legislative agent compensation, expenses for food, beverages, and receptions/events, and lobbying expenses. This Court should take judicial notice of data compiled on the Kentucky Legislative Ethics Commission's website, as "[a] court may properly take judicial notice of public records and government documents, including public records and government documents available from reliable sources on the internet." *Polley v. Allen*, 132 S.W.3d 223, 226 (Ky. App. 2004).

Trade association KCTA trumpets the need for "tax neutrality" for cable and satellite television providers, as its sole concern is for its members' competitive interests.[4] The Cabinet seeks to prop up a tax scheme that generates revenue and vests total control over the funds received with the General Assembly. In their haste to advance their financial interests over the Cities' constitutional rights, Appellants suggest that the Kentucky Constitution should be shunned for commercial convenience. The Cities' constitutional rights cannot be taken away by a statute, and the Court of Appeals' decision should be affirmed.

II. Cities historically collected franchise fees from communications and cable service providers under §§ 163 and 164 of the Kentucky Constitution, but the Telecom Tax now forbids their collection.

For decades before the Telecom Tax was enacted, pursuant to §§ 163 and 164 of the Kentucky Constitution, Kentucky cities collected franchise fees from cable service and some communications service providers that received permission through franchise agreements to use a city's roads and other rights-of-way to lay or string cables connecting their local distribution facilities to subscribers' homes. (Opinion at 3; TR 796, Trial Court's Opinion and Order (hereafter, the "T.C. Order"), at 2).[5] Those Sections provide:

> ***§ 163. Public utilities must obtain franchise to use streets.***
> No street railway, gas, water, steam heating, telephone, or electric light company, within a city or town, shall be permitted or authorized to construct its tracks, lay its pipes or mains, or erect its poles, posts or other apparatus along, over, under or across the streets, alleys or public grounds of a city or town, without the consent of the proper legislative bodies or boards of such city or town being first obtained; but when charters have been heretofore granted conferring such rights, and work has in good faith been begun thereunder, the provisions of this section shall not apply.

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[4] KCTA's *amicus curiae*, Charter Communications, Inc. ("Charter"), echoes this refrain. Charter filed the "Brief of Amicus Curiae Charter Communications, Inc. in Support of Appellant Kentucky CATV Association, Inc." (hereafter, "Charter Br.").

[5] The T.C. Order is attached as Appendix 3.

> ***§ 164. Term of franchises limited — Advertisement and bids.***
> No county, city, town, taxing district or other municipality shall be authorized or permitted to grant any franchise or privilege, or make any contract in reference thereto, for a term exceeding twenty years. Before granting such franchise or privilege for a term of years, such municipality shall first, after due advertisement, receive bids therefore publicly, and award the same to the highest and best bidder; but it shall have the right to reject any or all bids. This section shall not apply to a trunk railway.

Ky. Const. §§ 163, 164. In addition to franchise fees, local governments received from the Commonwealth the intangible portion of the public service corporation property tax imposed on cable and communications service providers under KRS § 136.120.[6]

The Telecom Tax took away both of these revenue sources for Kentucky's cities. Under the Telecom Tax, the Commonwealth now imposes excise and gross revenue taxes on multichannel video programming ("MVP") services (i.e., cable television and direct broadcast satellite television) and a gross revenues tax on communications services (i.e., telephone services via land and mobile lines). *See* KRS §§ 136.604, 136.616. Telecom Tax revenue flows into a "Gross Revenues and Excise Tax Fund" (the "GR Fund") and then is allocated among the Commonwealth, political subdivisions (including Kentucky cities), school districts, and special districts. *See* KRS § 136.648(1), (3).

The amount distributed each month among political subdivisions, school districts, and special districts is capped at $3,034,000, and is referred to as the "monthly hold harmless amount" in that the intent was that no city would suffer a loss of revenue. *See* KRS §§ 136.652 (2), 136.650 (2)(c). The portion of this amount distributed to each of these bodies is calculated by statute, which required political subdivisions to certify to the Department of Revenue the local franchise fees they historically collected from

[6] Because the federal Telecommunications Act of 1996 exempts satellite companies from local taxes and fees, these companies were not required to pay franchise fees to local governments before the enactment of the Telecom Tax. *See* 47 U.S.C. § 152; *Directv, Inc. v. Treesh*, 487 F.3d 471, 473-74 (6th Cir. 2007).

communications and cable service providers and any other fees collected to fund public educational and government access programming between July 1, 2004, and June 30, 2005. *Id.* § 136.650. From this information, each body received a "local historical percentage" of the monthly hold harmless amount based on the amount of its historical collections as a ratio of the total collections of all parties participating in the GR Fund. *Id.* § 136.650(2)(d. Most of the money remaining after the purported "monthly hold harmless" distributions are made is moved into the Commonwealth's General Fund. *Id.* § 136.652. For example, originally, the Telecom Tax called for $1,250,000 to be deposited in the General Fund each month, with this amount "adjusted on a prospective basis." *Id.* § 136.652(3). In fact, this amount was raised by 22 percent to $1,523,322.75. (Cab. Br. at 9 n. 8 (citing R. 291, fn.5)).

The Telecom Tax requires political subdivisions, including cities, to participate in the GR Fund and compels each political subdivision to "relinquish its right to enforce the portion of any contract or agreement that requires the payment of a franchise fee or tax on communications services and multichannel video programming services." *Id.* § 136.650(1)(b)(2. Section 136.660 (1) forbids political subdivisions from:

> (a) Levying any franchise fee or tax on multichannel video programming service or communications service, or collecting any franchise fee or tax from providers or purchasers of multichannel video programming service or communications service;
>
> (b) Requiring any provider to enter into or extend the term of any provision of a franchise or other agreement that requires the payment of a franchise fee or tax; or
>
> (c) Enforcing any provision of an ordinance or agreement to the extent that the provision obligates a provider to pay to the political subdivision a franchise fee or tax.

A "franchise fee or tax" includes "[a]ny tax, charge, or fee, that is required by ordinance or agreement to be paid to a political subdivision by or through a provider, in its capacity as a provider" no matter if it is "[d]esignated as a franchise fee" or "[i]ntended as compensation for the use of public or private rights-of-way, the right to conduct business, or otherwise." *Id.* § 136.660(2)(a). Significantly, a political subdivision that imposes or attempts to impose a franchise fee or tax may not receive any share of Telecom Tax proceeds for the period that the imposition or attempt occurs. *Id.* § 136.660(4). If a provider actually pays a franchise fee, it is entitled to a credit in the amount paid against the amount due under the Telecom Tax. *Id.* § 136.660(5.

The Telecom Tax not only prohibits cities from collecting franchise fees from communications and cable service providers, but also excludes those providers from having to pay the public service corporation property tax. *Id.* § 132.825(4 (stating that revenues from former public service corporation property tax are to be replaced by the Telecom Tax). Thus, the Telecom Tax erased two revenue sources for Kentucky cities.

III. The Telecom Tax has not held cities harmless as promised.

The Telecom Tax was enacted with the intent and a promise that local governments would be "held harmless" by the Cabinet's distributions, which were intended to replace the revenue cities received from franchise fees and the intangible portion of the public service corporation property tax. (T.C. Order at 3-4). In actuality, however, local governments only have been receiving 83% of the amount that they historically received from those sources, creating a disastrous shortfall. (Cab. Br. at 10).

While the Telecom Tax caps the hold-harmless amount for local governments at $36,408,000 per year, the annual amount of reported historical collections actually totaled

$42,100,000. (T.C. Order at 4; Cab. Br. at 10). This disparity was created when the General Assembly curiously set the hold-harmless cap *before* local governments certified their historic collection amounts. Even though the Telecom Tax was signed into law with its hold-harmless cap on March 18, 2005, the certifications of historic collections were not due until December 1, 2005. *See* H.B. 272, 2005 Gen. Assem., Reg. Sess. (Ky. 2005) (denoting passage on March 18, 2005); KRS § 136.650(1)(b) (noting the December 1, 2005 submission date).

In real dollars, and despite the "hold harmless" promise, local governments have lost nearly *$60 million in revenue* owing to the Telecom Tax. (*See* T.C. Order at 11 (calling the Telecom Tax "a disaster for local governments")).[7] This calamity for local governments, which the framers took specific steps to prevent a century ago, has been a boon for the Commonwealth. Due to this new taxing scheme, between January 1, 2006 and April 30, 2016, $626,705,981 has gone into the General Fund owing to the Telecom Tax—a revenue stream that did not exist before January 1, 2006. (*See* Reports of General Fund Receipts available at http://www.osbd.ky.gov/publications/taxreceipts.htm, attached as Appendix 4).[8]

IV. The trial court denied the Cities' motion for judgment on the pleadings and granted KCTA's and the Commonwealth's cross-motions.

The Cities filed a declaratory judgment action in 2011 against Appellants Lori Hudson Flanery and Thomas B. Miller (in their representative capacities as the officials

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[7] In just the first five fiscal years of the Telecom Tax (through December 31, 2010), the Cities suffered $449,600 in lost revenues from franchise fees and the intangible portion of the public service corporation property tax (approximately $223,500 for Florence, $104,950 for Winchester, $40,000 for Greensburg, and $81,150 for Mayfield). (TR 206, Memo in Support of Plaintiffs' Motion for Judgment on the Pleadings, at 215-16).

[8] Under *Polley*, 132 S.W.3d at 226, this Court should take judicial notice of data compiled on the Office of the State Budget Director's website. *See supra* note 3.

responsible for administering the Telecom Tax) to challenge the Telecom Tax's constitutionality. (TR 1, Complaint). KCTA intervened to represent the interests of its constituents, eighteen providers of cable television, high-speed Internet access, and voice services around Kentucky who support the Telecom Tax. (TR 29, KCTA's Motion to Intervene). The parties took limited discovery and then filed competing motions for judgment on the pleadings. (TR 203, Plaintiffs' Motion for Judgment on the Pleadings; TR 283, Cabinet's Memorandum in Opposition to Plaintiffs' Motion for Judgment on the Pleadings and Cross-Motion for Judgment on the Pleadings; TR 310, KCTA's Memorandum in Opposition to Plaintiffs' Motion for Judgment on the Pleadings and Cross-Motion for Judgment on the Pleadings).

The Cities sought to invalidate those provisions of the Telecom Tax that infringe on the rights the framers gave them in §§ 163 and 164 to levy and collect franchise fees under their franchise agreements. (TR 206, Memo in Support of Plaintiffs' Motion for Judgment on the Pleadings, at 217-25). The Cabinet and KCTA responded that §§ 163 and 164 do not prevent the General Assembly from exercising control over the levy and collection of franchise fees. They claimed that those provisions only vested cities with authority over the original occupation of their public rights-of-way and that, even if §§163 and 164 did require the payment of compensation for a franchise, cities receive funds through the Telecom Tax. (TR 283 at 294-300; TR 310 at 317-20). KCTA also argued that the Telecom Tax was enacted in line with the Commonwealth's retained powers and § 181 of the Kentucky Constitution.[9] (TR 310 at 323-26).

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[9] As in its brief to this Court (KCTA Br. at 7-8), KCTA opined to the trial court that the Cities' "real motivation" in filing suit was to "coerce the Legislature," citing a KLC staff member's statement in a shorthand transcript out of context. (TR 310 at 317). The trial

The trial court denied the Cities' motion for judgment on the pleadings and granted the Cabinet's and KCTA's cross-motions. (T.C. Order at 1). The court held that §§ 163 and 164 "do not prohibit the General Assembly from exercising control over the levy and collection of franchise fees." (*Id.* at 7). The court relied on cases analyzing the Commonwealth's power over franchises by regulating rates. (*See id.* at 8-9). The court also stated, even though the Cabinet (charged with defending the constitutionality of the Telecom Tax) did not support this argument, that § 181 of the Kentucky Constitution gives the Commonwealth certain retained powers over franchising such that it can prohibit cities from collecting franchise fees. (*See id.* at 9-11).

V. The Court of Appeals declares that the Telecom Tax is unconstitutional to the extent it violates §§ 163 and 164 of the Kentucky Constitution.

A three-judge panel of the Kentucky Court of Appeals unanimously reversed the trial court's order and declared the Telecom Tax unconstitutional to the extent it violates the rights of Kentucky's cities granted under §§ 163 and 164 of the Kentucky Constitution. After reciting facts that the trial court found, the Opinion identified a single "question of law" on appeal: "whether the Telecom Tax violates Kentucky Constitution Sections 163 and 164." (Opinion at 5). To resolve the question, the court first stated that KRS § 136.660(1)(a) "expressly forbids [the Cities] from collecting franchise fees." (*Id.* at 6). The court next confirmed that the Telecom Tax "seeks to impose state taxes at the expense of franchise fees historically imposed and collected by" the Cities. (*Id.* at 7). The court then explained that "[t]he Commonwealth may not by legislative fiat abrogate [the

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court ignored KCTA's opinion, as should this Court. The staff member's statement that a lawsuit challenging legislation "will ruffle feathers in the legislature" merely advised the board of the potential fall-out of litigation, and the statement does not support KCTA's concocted "presumption" of attempted coercion or speak to the merits of this case. (*See* TR 630, Plaintiffs' Reply to Defendants' Memoranda in Opposition and Response to Defendants' Cross-Motions for Judgment on the Pleadings, at 632 n.2).

Cities'] constitutionally delegated prerogative to grant a franchise and collect franchise fees." (*Id.* at 8). And finally, giving effect to the framers' intent in 1891, the court held that "the Telecommunications Tax violates Kentucky Constitution Sections 163 and 164 by prohibiting [the Cities] from assessing and collecting franchise fees."[10] (*Id.*)

ARGUMENT

I. Standard of Review

Whether a statute is constitutional ordinarily is a question of law. *See Kohler v. Benckart*, 252 S.W.2d 854, 856-857 (Ky. 1952). Questions of law are subject to *de novo* review. *See Gosney v. Glenn*, 163 S.W.3d 894, 899 (Ky. App. 2005).

II. The Court of Appeals Correctly Held that the Telecom Tax Violates §§ 163 and 164 of the Kentucky Constitution as Applied to Kentucky Cities.

The Court of Appeals properly held that §§ 163 and 164 of the Kentucky Constitution grant cities the rights to levy and collect franchise fees from communications and cable providers using city streets and rights-of-way to provide their services, and correctly declared the Telecom Tax unconstitutional to the extent it violates these rights. Cities historically collected franchise fees under these two provisions. (*See* T.C. Order at 2 ("Prior to enactment [of the Telecom Tax], local governments collected franchise fees . . . pursuant to the Kentucky Constitution Sections 163 and 164"); Opinion at 3 (citing T.C. Order)). The Cabinet even admits that §§ 163 and 164 "envision the collection of tolls or charges sometimes called 'franchise fees' as remuneration to the local authority for the use of the rights of way" and states that "we agree with the Court of Appeals' Opinion in that remuneration to the Appellees is envisioned in exchange for

[10] The Court of Appeals then denied KCTA's and the Cabinet's Petitions for Rehearing, though it issued a corrected opinion to address a typographical error.

the grant of a franchise." (Cab. Br. at 2, 21 (citing *City of Owensboro v. Top Vision Cable Co. of Ky.*, 487 S.W.2d 283, 287 (Ky. 1972))).

Appellants cannot overcome the express requirement that the framers inserted in § 164 that, when awarding a utility franchise, a city must seek the "highest and best" bid for that franchise. Appellants' contrived arguments contradict the common-sense interpretation given to § 164 for over a century that the bidding requirement's purpose is to ensure that cities "obtain the greatest price possible" for the "sale" of their franchises, which by necessity means that cities get to collect money from the winning bidder. *Stites v. Norton*, 101 S.W. 1189, 1190 (Ky. 1907). The notion that § 164 does not delegate to a city the right to actually collect money from a winning bidder is impractical, lacks common sense, conflicts with historic practices, and is an invalid interpretation of the Kentucky Constitution. *See Meredith v. Kauffman*, 169 S.W.2d 37, 39 (Ky. 1943) ("The Constitution is concerned with substance and not with form and its framers did not intend to forbid a common-sense application of its provisions."); *see also* 16 Am. Jur. 2d *Constitutional Law*, § 62 (2012) ("Constitutional language must receive a liberal and practical commonsense construction."); *id.* at § 76 ("no forced, strained, unnatural, narrow, or technical construction should ever be placed upon the language of a constitution" and "[a] court will not construe a constitutional provision to arrive at a strained, impractical, or absurd result.").

A. The Kentucky Constitution gives cities the right to collect franchise fees through the "highest and best bidder" requirement.

The Telecom Tax violates §§ 163 and 164 of the Kentucky Constitution by barring Kentucky's cities from collecting franchise fees from communications and cable service providers. Legislation cannot alter, amend, or destroy a fundamental grant of

sovereignty in the constitution and, therefore, the portions of the Telecom Tax that conflict with the constitution are void. *See Kuprion*, 888 S.W.2d at 681; *Comm. v. Kash*, 967 S.W.2d 37, 45 (Ky. App. 1997).

Section 163 provides that public utilities must obtain a franchise to use a city's streets or rights-of-way. Its purpose is "to prevent the Legislature from authorizing the indiscriminate use of the streets of the city by public utilities without the city being able to control the decision as to what streets and what public ways were to be occupied by such utilities." *Mt. Vernon Tel. Co., Inc. v. Mt. Vernon*, 230 S.W.2d 451 (Ky. 1950). Paired with § 163, § 164 governs a city's issuance of a utility franchise. It requires that a city advertise the franchise and only award the franchise (for a term not to exceed twenty years) to the "highest and best bidder." Ky. Const. § 164. Sections 163 and 164 must be construed together: § 163 "prevents the imposition of fixtures upon the streets without the consent of the city or town affected," and § 164 outlines how to obtain such consent. *Ashland v. Fannin*, 111 S.W.2d 420, 423 (Ky. 1937); *see also Cumberland Tel. & Tel. Co. v. Calhoun*, 151 S.W. 659, 661-62 (Ky. 1912) ("These sections of the Constitution must be read together, as the right to occupy the streets and public ways conferred by section 163 can only be granted in the manner provided in section 164." (quoting *Rural Home Tel. Co. v. Ky. & Ind. Tel. Co.*, 107 S.W. 787, 790 (Ky. 1908))).

Cases dating back to 1907 discuss § 164 in the context of "selling" a "valuable" franchise through a bidding process to obtain the "highest and best value" and the "greatest price possible" for the use of a municipality's streets and rights-of-way. *See, e.g., E.M. Bailey Distrib. Co. v. Conagra, Inc.*, 676 S.W.2d 770, 773 (Ky. 1984) (stating that the purpose of § 164 is "to prevent governmental agencies of any kind from giving

away, or disposing of at *inadequate prices*, the rights and privileges which belong to its citizens and to compel the disposition of public property to be accomplished publicly *and for the highest and best value*") (emphasis added); *Hatcher v. Ky. & W. Va. Power Co.*, 133 S.W.2d 910, 915 (Ky. 1939) (describing the purpose of § 164 in connection with "the *sale* of a franchise" as "to protect the rights of citizens to receive the *value* of the privilege to be granted away and prevent their councils from granting *valuable* privileges to favorites without any *sufficient consideration*") (emphasis added); *Stites v. Norton*, 101 S.W. 1189, 1190 (Ky. 1907) (discussing the "*sale*" of a franchise for "the sum of $100,150" and explaining that § 164 ensures that a municipality's citizens "*obtain the greatest price possible*" for the rights and privileges granted by a franchise) (emphasis added); *Frankfort Tel. Co. v. Bd. of Council City of Frankfort*, 100 S.W. 310, 311 (Ky. 1907) (stating that § 164 forbids giving away a franchise which forestalls "the temptation to corrupt city councils"). These cases confirm that the "highest and best bidder" requirement necessarily involves the city's collection of consideration, *i.e.*, a franchise fee, in exchange for the grant of a utility franchise.

The Kentucky Constitution need not use the term "franchise fees" to give cities the right to collect franchise fees. Rather, cities have powers "expressly granted by the constitution and statutes . . . plus such powers as are necessarily implied or incident to the expressly granted powers, and which are indispensable to enable the municipality to carry out its declared objects, purposes and expressed powers." *Griffin v. City of Paducah*, 382 S.W.2d 402, 404 (Ky. 1964). For over 100 years, Kentucky's courts have understood that the bidding requirement in § 164 was designed to ensure that cities "sell" "valuable" franchises for the "greatest price possible" to shield against corruption. It is absurd to

argue that the framers only intended to allow cities to sell franchises but not to collect franchise fees under § 164.

Yet, the Telecom Tax improperly bars Kentucky's cities from collecting franchise fees. It forces cities to relinquish any right to franchise fees in existing agreements and prevents them from levying or collecting franchise fees, including any fees "[i]ntended as compensation for the use of public or private rights-of-way." KRS § 136.650(1)(b)(2) (compelling participation in the Telecom Tax); *id.* § 136.660(1) (forbidding cities from levying or collecting franchise fees).[11] It prevents cities from ensuring that they receive the "greatest price possible" by seeking the "highest and best" bid for the privileges granted to communications and cable service providers through a franchise, which courts have declared to be an express purpose of §§ 163 and 164. The Telecom Tax thus breaches the "letter and spirit" of the constitution, and it is unconstitutional to the extent it violates §§ 163 and 164. *See Campbell Cnty. v. Comm.*, 762 S.W.2d 6, 9 (Ky. 1988) ("[T]here is no principle of constitutional construction more firmly fixed than that 'constitutional provisions [must] be enforced according to their letter and spirit, and cannot be evaded by any legislation . . . which, though not in terms trespassing on the letter, yet in substance and effect destroy the [constitutional] grant or limitation.'" (final alteration in original) (quoting *Comm. v. O'Harrah*, 262 S.W.2d 385, 389 (Ky. 1953).

Cities must operate and provide services to their constituents, from police and fire protection to the maintenance of city parks and everything in between. The Kentucky

[11] In contradictory fashion, the Cabinet states that "[e]very political subdivision, school district, and special district is required to participate in the [GR Fund]" and that the Telecom Tax "prohibits" cities from levying franchise fees and enforcing contracts to pay franchise fees, but also argues that cities have the right to "opt out" of the Telecom Tax and continue collecting franchise fees. (Cab. Br. at 6, 7, 15, 26). Indeed, KRS § 136.650 makes clear that participation in the Telecom Tax is mandatory for cities.

Constitution recognizes that one way in which cities can obtain needed funds is through the sale of utility franchises. To prevent corruption in awarding this precious right, the Kentucky Constitution mandated that franchises be sold through a bidding process to guarantee the greatest price possible. The Cities' and Court of Appeals' common-sense interpretation of §§ 163 and 164 gives effect to their letter and spirit, as they are intended to ensure that cities obtain monetary compensation for their valuable franchises.

B. Appellants' argument distorts the letter and spirit of the "highest and best bidder" requirement in § 164.

Unlike the Cities' and Court of Appeals' practical interpretation of § 164, which comports with 100 years of Kentucky case law, Appellants' view skews the "highest and best bidder" requirement for granting a franchise and makes it impossible for cities to follow the constitution and ensure that they receive *any* money in exchange for their utility franchises. Under Appellants' theory, § 164 has no practical effect, even though the bidding requirement in that Section is absolute. *See Ray v. Owensboro*, 415 S.W.2d 77, 79 (Ky. 1967) ("We have held that the right granted under [§§ 163 and 164] to the cities is absolute and can not be taken away by the legislature."); *Union Light, Heat & Power Co. v. Ft. Thomas*, 285 S.W. 228, 231 (Ky. 1926) ("We have repeatedly held that a city or town can consent to the occupancy of its streets by a public utility only in the manner pointed out by section 164 of the Constitution."). In essence, Appellants aver that cities need not actually comply with § 164, because they have no right to conduct a "highest and best" bidding process and no direct entitlement to monetary compensation.[12]

[12] For example, KCTA avers that cities only are entitled to receive "value" for their franchises, eschewing the "highest and best" language of § 164. (*See* KCTA Br. at 19 ("Local Governments, moreover, do not require authority over franchise fees to obtain value for the initial franchises they grant.")).

Of course, Kentucky courts do not agree with Appellants that the bidding process in § 164 is a mere suggestion, and not a requirement. For over a century, courts have held that cities must consent to the use of their streets or rights-of-way by utilities by granting a franchise in accordance with § 164, which requires cities to receive bids publicly after due advertisement and to then award the franchise to the "highest and best bidder." Failure to observe these obligations renders a franchise null and void. *See E.M. Bailey Distrib. Co.*, 676 S.W.2d at 771; *Frankfort Tel. Co.*, 100 S.W. at 311.

Appellants offer that cities receive funds for their franchises via the Telecom Tax—while omitting, of course, that the shortfall all local governments have experienced is nearing $60 million since 2006—but they are mistaken that these distributions satisfy §§ 163 and 164. Cities must pursue "the greatest price possible" for the use of their streets and rights-of-way via the bidding process in § 164, but the Telecom Tax prevents Kentucky cities from exercising any control over whether this occurs. Instead, under the Telecom Tax, the General Assembly has total control over the amounts collected and distributed to cities for their franchises. Currently, cities cannot obtain "the greatest price possible" for the use of their streets and rights-of-way, despite that being the acknowledged purpose of §§ 163 and 164.

Moreover, as the Cities have noted to both courts below—an argument neither the Cabinet nor KCTA ever have squarely addressed—if Appellants' interpretation carries the day, nothing will prevent the General Assembly from making the situation even worse for the Cities by periodically or continually reducing future amounts distributed to

cities under the Telecom Tax, or even eliminating those distributions entirely.[13] If Appellants prevail, the amounts cities receive for their utility franchises in the future will be determined based not on a bidding process under § 164, but instead on the relative success of service providers and local governments in lobbying the Legislature. The drafters of the constitution recognized long ago the danger of this outcome. While the Commonwealth currently distributes $36,408,000 each year to political subdivisions, school districts, and special districts, nothing ensures that cities will continue to receive any, much less adequate, compensation if the General Assembly can lower this amount simply by amending its own tax scheme and without regard to whether the Cities receive the "highest and best" value. Appellants' argument eviscerates the cities' constitutional right to obtain "the greatest price possible" for a franchise from "the highest and best bidder," and places all control over franchise fee revenue in the hands of the General Assembly, making the money subject to lobbying interests and not city control.

Let there be no mistake: for the "highest and best bidder" requirement in § 164 to have any practical effect it is indispensible that cities have the right to levy and collect money in the form of franchise fees from utilities. Appellants dispute this by arguing that the Cities still can have a bidding process based on non-monetary factors. (Cab. Br. at 21-22; KCTA Br. at 19-20). Yet, just because non-monetary factors may be considered in the bidding process does not mean that the monetary component, which has been a part of the process for over 100 years, can be eliminated all together.

Section 164 requires a bid to be the *highest* and the best—this includes qualitative

[13] The Cabinet purports to address this argument, but a review of its brief reveals that the Cabinet does not guarantee any future Telecom Tax payments to Kentucky cities. (Cab. Br. at 23-26). Instead, the Cabinet offers only the illogical suggestion that Kentucky cities can simply "opt out" of the Telecom Tax. (*Id.* at 26).

and quantitative considerations. Kentucky's highest Court stated over eighty years ago that franchises are to be re-let at least every twenty years so that, in addition to having the chance to revise non-monetary terms, cities can obtain enhanced "value" for the franchises—which in this context only could mean "better monetary compensation." *Ky. Util. Co. v. Bd. of Comm'rs*, 71 S.W.2d 1024, 1028 (Ky. 1934). That Court explained "the main purpose" behind § 164 as "to insure that every so often the municipality should have the opportunity of revising the terms of the franchise which it had granted as to rates, quality, service, and the like" and "*to have the advantage of obtaining from time to time for the franchise its value which most likely would be enhanced by the growth of population and business*." *Id.* (emphasis added). The Court also quoted Judge Carroll, a member of the Constitutional Convention of 1890, who explained the fiscal reason why franchises must be re-let periodically under § 164:

> Further illustrating the intention of the section, the limitation of 20 years upon the time for which franchises might be granted was added, as what would be an *adequate price* for a franchise granted to a public utility corporation to use the streets of a city to-day might be *a mere pittance* 20 years hence. The *value* to the owners of the right granted would keep pace with the growth, wealth, and population of the city, and unless at some future time the city had the right to obtain additional *compensation* for the privilege it would give the grantees of the franchise undue advantage, and deny to the city the right to *exact a consideration in keeping with the value of the privilege bestowed.*

Id. at 1029 (quoting *Hilliard v. George G. Fetter Lighting & Heating Co.*, 105 S.W. 115, 118 (Ky. 1907)) (emphasis added). It cannot be argued seriously that Judge Carroll used the phrase "a mere pittance" in a way other than to connote a monetary payment.[14]

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[14] Even the cases that the Cabinet cites as stating that the bidding process involves more than the receipt of a fee recognize that the collection of money is part of the process. *See, e.g., Louisville Home Tel. Co. v. City of Louisville*, 113 S.W. 855, 861 (Ky. 1908) (stating "the city is receiving annually over $2,000" for its franchise); *Baskett v. Davis*, 223 S.W.2d 168, 169 (Ky. 1949) (noting franchise sold for $1,375 fee and stating that "force

In sum, Appellants cannot avoid that for over a century, cities have collected franchise fees in exchange for granting franchises under §§ 163 and 164. Moreover, courts repeatedly have described the bidding process in § 164 as ensuring the *sale* of a franchise for an adequate *price*. *See Stites*, 101 S.W. at 1190 *City of Florence v. Owen Elec. Coop., Inc.*, 832 S.W.2d 876, 881 (Ky. 1992); *Berea College Utils. v. Berea*, 691 S.W.2d 235, 236 (Ky. App. 1985); *Hatcher v. Ky. & W.V. Power Co.*, 133 S.W.2d 910, 915 (Ky. 1939). The General Assembly wrested away cities' right to compensation in exchange for the use of their streets and rights-of-way, and this is exactly what § 164 was designed to prevent. Appellants cannot rewrite history to violate the letter and spirit of the Kentucky Constitution and take from the Cities the right to collect franchise fees.

C. The fact that the Commonwealth retains some authority over franchising does not nullify the "highest and best bidder" requirement.

Appellants try to sidestep the "highest and best bidder" requirement in § 164 by citing cases regarding the General Assembly's retained authority to regulate utility rates and services, by asserting that cities do not have sole authority over franchises, and by criticizing the Court of Appeals' reliance on a 1912 decision regarding §§163 and 164. The Cities agree with Appellants that cities do not enjoy sole authority over all franchise matters. However, Appellants make a logical leap to advance this argument beyond its appropriate application and mischaracterize the Court of Appeals' citation to *Cumberland Telephone & Telegraph Co. v. City of Calhoun*, 151 S.W. 659 (1912).

Most case law on the General Assembly's "retained authority" comes in the context of decisions related to the Public Service Commission. The Cities agree that the

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is to be given to both the controlling words 'highest' and 'best' found in the constitution").

Commonwealth has the authority to regulate utility rates and services—as *those powers were not delegated to cities by the Kentucky Constitution*. As a result, case law discussing the Commonwealth's retained power over franchises by its ability to control utilities' rates and services is off point. The issue here is not control over rates charged or services provided to customers, but the Cities' authority to collect utility franchise fees, rights expressly delegated to them in §§ 163 and 164 that the Commonwealth did not retain.

For example, the Cabinet cites *Southern Bell Telephone & Telegraph Co. v. City of Louisville*, 96 S.W.2d 695 (Ky. 1936) (Cab. Br. at 13), to support its position regarding the Commonwealth's retained powers, but that case does not permit the General Assembly to usurp cities' right to collect franchise fees. In *Southern Bell*, the plaintiff challenged the Public Service Commission Act, which gave a state agency complete control over the rates and services of certain utilities such as telephone companies. 96 S.W.2d at 697. The Court held that this did not violate §§ 163 or 164 because "a franchise granted by a municipality is granted subject to the right of the state to exercise its police power in this respect." *Id.* In other words, the constitution delegated to cities the authority to grant a franchise to use its rights-of-way to the "highest and best bidder," but did not delegate police powers over a franchise *after* a city grants it. *Southern Bell* thus does not address the issue before this Court.

Likewise, in *City of Florence*, another case the Cabinet cites regarding legislative control over franchising (Cab. Br. at 24), the city challenged state statutes that set local electric service areas. 832 S.W.2d at 878. The city had granted a company an exclusive franchise in the city, and the defendant had provided electrical service to consumers in separate and abutting areas in the county. *Id.* The areas the companies served had been

certified to each of them as their exclusive service territory by the Public Service Commission. *Id.* When the city annexed certain areas of the county, the company serving the city under an exclusive franchise claimed the right to serve the annexed areas and the city supported this right which it believed to be conveyed by §§ 163 and 164. *Id.* The Court disagreed, holding that "[i]t is a misconception to characterize Sections 163 and 164 as eliminating total legislative authority regarding franchising." *Id.* at 879. Instead, the statutes at issue only were unconstitutional "to the extent [they] purport[ed] to give a utility the right to use a city's streets without its consent." *Id.* at 881. The constitution grants this right to cities through their ability to sell franchises to the "highest and best bidder," but "[a] franchise thus granted by a municipality is granted subject to the right of the state to exercise its police power[.]" *Id.* The Court held that the constitution "did not deprive or strip the legislature of the right to control utility service territories and found no constitutional grant guaranteeing a municipality the authority to control retail electric services territories within its limits." *Id.* at 882. Yet, again, the Court did not address cities' right to levy franchise fees or say that the Commonwealth's police power bears on a city's right to require a utility to pay franchise fees.

The Commonwealth did not retain the authority to grant utility franchises following a bidding process. The framers delegated the authority to grant franchises and collect franchise fees to Kentucky cities in §§ 163 and 164. The Kentucky Constitution understandably provides cities exclusive jurisdiction over the granting of rights to use each city's rights-of-way, including the "sale" (for a franchise fee) of such a right to the "highest and best bidder" for the "greatest price possible." *See, e.g., City of Florence*, 832 S.W.2d at 879 (finding a statute unconstitutional "to the extent it purports to give a utility

the right to use a city's streets without its consent"); *Benzinger v. Union Light, Heat & Power Co.*, 170 S.W.2d 38, 41-42 (Ky. 1943) (finding that there "was not a preemption of the field of municipal authority over its public streets, alleys and property so as to deny it to choose for itself the method or manner of encumbering or placing burdens on such public property over which it has exclusive jurisdiction").

The Cabinet also attacks the Court of Appeals' decision below as having "misconceived" *Cumberland Telephone & Telegraph Co. v. City of Calhoun* as recognizing cities' right to collect franchise fees (Cab. Br. at 14), but the Court of Appeals properly relied on this case. (Opinion at 8 (citing *Cumberland Tel.*, 151 S.W. at 661-62)). Indeed, *Cumberland Telephone* does not "merely recognize[] that remuneration is envisioned for a franchise granted" (Cab. Br. at 14), but instead states that "the right to occupy [city] streets and public ways conferred by section 163 can only be granted in the manner provided in section 164." *Cumberland Tel.*, 151 S.W. at 662 (internal quotation marks omitted) (quoting *Rural Home Tel. Co. v. Ky. & Ind. Tel. Co.*, 107 S.W. 787 (Ky. 1908)). In other words, Kentucky's highest Court held in 1912 that a utility franchise only can be granted if the bidding process set forth in § 164 is followed, and that process necessarily involves the levy and collection of a franchise fee.

"Section 164 of the Kentucky Constitution has existed since 1890, and although case law has diluted its effectiveness to some extent, the cases which limit the requirement for advertisement and competitive bidding should be interpreted on a very narrow basis." *E.M. Bailey Distrib. Co.*, 676 S.W.2d at 773. While Appellants correctly aver that the General Assembly has certain retained powers related to franchising, they construe those powers too broadly. The Cities do not assert that §§ 163 and 164 eliminate

total legislative authority regarding franchising or that a franchise is purely local in character. Rather, the Cities contend—and the Court of Appeals agreed—that the General Assembly has the power to *regulate existing franchises*, while the framers delegated to Kentucky's cities the power to *grant* franchises through a bidding process and to levy and collect franchise fees in conjunction therewith. Because the dispute here is about competitive bidding, not police powers, Appellants' argument regarding the Commonwealth's "retained powers" fails.

D. The "original occupation" limitation on cities' authority over franchising does not impact the "highest and best bidder" requirement.

Appellants also invoke the "original occupation" limitation on franchises to avoid the "highest and best bidder" requirement and the cities' right to collect franchise fees guaranteed by § 164. Under that relatively undeveloped doctrine,[15] Kentucky courts have held that neither §§ 163 nor 164 prevents the General Assembly from *regulating* franchises *after* they have been granted, as §§ 163 and 164 only control the "original occupation" of a city's streets and rights-of-way. But this limitation in no way negates the bidding requirements in § 164, nor does it give the Commonwealth the authority to forbid cities from collecting franchise fees. As a result, the Court of Appeals correctly rejected Appellants' "original occupation" argument.

The basic premise of the "original occupation" limitation derives from *Kentucky Utilities Co.*, 71 S.W.2d 1024. This case addressed the constitutionality of a state statute that compelled cities to reoffer and grant a new franchise to the prior holder of a franchise

[15] In contrast to the many cases discussing the "highest and best bidder" requirement in § 164 of the Kentucky Constitution, Kentucky courts have issued only three reported decisions on the "original occupation" limitation: *Ky. Util. Co. v. Bd. of Comm's of City of Paris*, 71 S.W.2d 1024 (1933); *Hatcher v. Ky. & W.V. Power Co., Inc.*, 133 S.W.2d 910 (Ky. 1939); *City of Florence v. Owen Elec. Coop., Inc.*, 832 S.W.2d 876 (Ky. 1992).

already granted if that prior holder is the "highest and best bidder" for the new franchise. The plaintiff held an electric franchise with a city that expired by its terms and requested that the city offer for sale to the "highest and best bidder" a franchise similar to the one expiring, as state law provided for such an offering. *Id.* at 1025. But the city had constructed its own electric plant and did not want to compete with the plaintiff, so the city refused to offer (or reoffer) the franchise. *Id.* After the plaintiff sued the city to compel it to reoffer the franchise, the city challenged the validity of the law requiring the reoffering to the prior franchise holder (currently codified at KRS § 96.010).

The Kentucky Court of Appeals upheld the statute as it determined that "the framers of the Constitution meant to vest the municipality with the right and power to control the *original occupation* of its public ways and streets by the utilities mentioned in [§ 163]." *Ky. Utils. Co.*, 71 S.W.2d at 1027 (emphasis added). The court explained:

> There is no language . . . in either section 163 or section 164 of the Constitution that takes away from the Legislature the right and power to require a municipality *once it has granted a franchise to a public utility* to give that utility . . . the opportunity on the expiration of its franchise of procuring a new one, on terms fair to the city, the utility, and the public, *by a bid which is highest and best in open competition.*

Id. (emphasis added). In other words, the General Assembly can require reoffering a franchise to the prior franchise holder without violating the constitution so long as the new franchise is acquired in line with the bidding procedures in § 164. While Appellants cite *Kentucky Utilities* to support their position, they fail to explain how the "original occupation" limitation affects a city's right to "sell" a franchise, *i.e.*, collect a franchise fee from the "highest and best bidder," for access to its streets and rights-of-way.

Appellants raised an argument to the Court of Appeals—and continue to this Court—based on language in *Kentucky Utilities* stating that the "power to grant

franchises as an original proposition inheres in the sovereignty of the state." 71 S.W.2d at 1026. The Court of Appeals noted this argument and dismissed it (Opinion at 6) because the court recognized that this decision contains additional, important language—specifically, that the Commonwealth "*may by constitutional or statutory provisions delegate that right to a local political subdivision such as a municipality*." *Ky. Utils. Co.*, 71 S.W.2d at 1026 (emphasis added). The Court of Appeals correctly recognized that the framers took the power to grant franchises and collect franchise fees away from the General Assembly by delegating these rights to Kentucky's cities in §§ 163 and 164. A statute cannot abolish those constitutionally delegated rights, nor could the framers have intended that the cable television lobby's desire for "tax neutrality" with satellite companies would supersede the Cities' right to obtain the "highest price possible" for their franchises.

III. Section 181 of the Kentucky Constitution Does Not Give the General Assembly Authority to Prohibit Cities from Collecting Franchise Fees.

Appellants take very different positions on the relevance of § 181 of the Kentucky Constitution to this case. The Cabinet, charged with defending the Telecom Tax, agrees with the Cities that § 181 does not apply here. (Cab. Br. at 26-27 ("[W]e believe that the franchise fee here at issue is not the occupational or license tax referred to in Ky. Const. §181, but instead compensation for the use of the public right-of-way.")). On the other hand, though no Kentucky appellate court opinion ever has discussed §§ 163, 164, and 181 together in this fashion, KCTA depicts § 181 as part of a triumvirate of franchise-related constitutional provisions and relies on § 181 as the foundation for its argument. (KCTA Br. at 2-3, 12; *see also* Charter Br. at 12-13). KCTA and Charter erroneously aver that § 181 gave the General Assembly authority to enact the Telecom Tax and strip

cities of their right to levy and collect franchise fees. The Court of Appeals correctly gave no credence to this argument.[16]

KCTA posits that, before the Telecom Tax, cities had collected "license fees on franchises" under § 181 and KRS §§ 91.200 and 92.280 (the General Assembly's delegation of the right to collect license fees on franchises) and that the Commonwealth simply took away this authority via the Telecom Tax. (KCTA Br. at 21-22). To make this argument, KCTA intentionally blurs the well-recognized distinction between franchise fees and license fees on franchises, and miscasts § 181. Indeed, to confuse the two concepts, KCTA repeatedly uses the terms "franchise fees," "fees on franchises," and "license fees" interchangeably. (*See*, *e.g.*, *id.* at 1 ("the General Assembly enacted the [Telecom Tax], thus taking back from municipal governments the authority to impose franchise fees"), 2 ("Section 181 expressly authorizes the General Assembly to regulate fees on franchises"), 3 ("Section 181 affords the General Assembly with the power to authorize ... local fees on franchises"), 4 ("the General Assembly expressly delegated the cities the authority not only to charge, but to determine the amount of license fees on franchises, as permitted under Section 181") (emphases added)).[17] Franchise fees and license fees on franchises are different matters, and the Cabinet refuses to offer an argument under § 181 owing to this distinction.

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[16] KCTA incorrectly contends that the Court of Appeals ignored their arguments regarding § 181. The court asked about that provision at oral argument, but, because it is not applicable to the Cities' constitutional right to levy and collect franchise fees, the Opinion properly does not discuss § 181.

[17] Charter employs a similar strategy. (*See* Charter Br. at 8 (stating that the Opinion "considered Sections 163 and 164, which do not mention franchise fees ... inexplicably ignoring Section 181, which does mention such fees") (emphases added)).

Section 181 relates to taxes levied for the benefit of local governments. The purpose of § 181 is "to enable each county to levy, collect and expand its own taxes, free from the control and influence of the General Assembly, and to prevent that body from levying a tax on property located in any county, for county government purposes." *Mitchell v. Knox Cnty. Fiscal Ct.*, 177 S.W. 279, 282 (Ky. 1915). Section 181 provides:

> The General Assembly shall not impose taxes for the purposes of any county, city or other municipal corporation, but may, by general laws, confer on the proper authorities thereof, respectively, the power to assess and collect such taxes. The General Assembly may, by general laws only, provide for the payment of license fees on franchises, stock used for breeding purposes, the various trades, occupations and professions, or a special or excise tax; and may, by general laws, delegate the power to counties, towns, cities and other municipal corporations, to impose and collect license fees on stock used for breeding purposes, on franchises, trades, occupations and professions. And the General Assembly may, by general laws only, authorize cities or towns of any class to provide for taxation for municipal purposes on personal property, tangible and intangible, based on income, licenses or franchises, in lieu of an ad valorem tax thereon: Provided, Cities of the first class shall not be authorized to omit the imposition of an ad valorem tax on such property of any steam railroad, street railway, ferry, bridge, gas, water, heating, telephone, telegraph, electric light or electric power company.

Reading § 181 in its entirety reveals that this Section has no bearing on the constitutionality of the Telecom Tax as applied to Kentucky cities. Franchise fees collected in exchange for the right to use a city's streets and rights-of-way are not the same thing as license fees on franchises, and only the latter is covered by § 181.

"[A] franchise fee such as that involved [in the application of § 164] is not a tax, but is instead a charge bargained for in exchange for a specific property right." *Berea College Utils.*, 691 S.W.2d at 237. Unlike a franchise fee, a license fee is a tax on the opportunity to do business or pursue an occupation in an area. *See Patrick v. City of*

Frankfort, 539 S.W.2d 275, 276 (Ky. 1976). A franchise involves a much more limited right "to do some act or acts which he cannot do without this grant from the sovereign power." *Mt. Vernon Tel. Co. v. Mt. Vernon*, 230 S.W.2d 451, 452 (Ky. 1950). An example is the right to access city streets and rights-of-way, which cities have the authority to grant under § 163 after following the bidding procedures in § 164. This Court has noted the distinction between franchise fees and license fees or taxes:

> The constitutional sections [163 and 164] do not grant a municipality the authority to franchise a right to sell electricity within the boundary of a city. The right to produce and sell electricity as a commercial product is not a prerogative of the government but is a business which is open to all and for that reason is not a franchise. *City of Princeton v. Princeton Electric Light & Power Co.*, 166 Ky. 730, 179 S.W. 1074 (1915), determined that the franchise which a municipality can grant is the use of its streets for the delivery of the light and power.

City of Florence, 832 S.W.2d at 879.

By its own terms, § 181 applies to license fees or taxes, and not the granting of franchises and assessment of franchise fees. A franchise fee is not a license fee or tax imposed for purposes of regulation or raising revenue such that it is falls within § 181. As § 181 does not apply to franchise fees, the General Assembly cannot abolish cities' right to collect franchise fees under § 181.

Even if § 181 did encompass the assessment of franchise fees, which it does not, it still does not conflict with a city's right to impose franchise fees upon a public utility under §§ 163 and 164. As explained above, while the Commonwealth retains certain authority with regard to franchising, the constitution delegates the power to grant franchises and levy and collect franchise fees to cities. *See Whitaker v. Louisville Transit Co.*, 274 S.W.2d 391, 395 (Ky. 1954) ("The right of a city to control the letting of franchises to intra-city utilities is derived from the Constitution and to that extent the

authority of the city is superior to that of the state."). The same is true regarding the authority § 181 allows the General Assembly to delegate to local governments. As the power to grant franchises and levy and collect franchise fees already has been delegated to cities under § 163 and § 164, it is not within the powers that can be delegated and taken away under § 181. *See id.* In other words, even if § 181 refers to the Commonwealth's ability to delegate the right to assess franchise fees—which it does not—this would not include franchise fees for the grant of a utility franchise to use a city's streets or rights-of-way, as that right already is delegated to the cities by §§ 163 and 164. Simply put, the existence of §181 does not eliminate or alter §§ 163 and 164.

As the trial court, the Cabinet, and the Court of Appeals all recognize, §§ 163 and 164 envision the cities' collection of franchise fees in exchange for granting a franchise, and cities historically have collected franchise fees under these provisions. Section 181 does not affect cities' power to grant franchises via the bidding procedure in § 164. Because the Court of Appeals correctly interpreted §§ 163 and 164, it did not need to address KCTA's argument concerning § 181—an argument that the Cabinet, charged with defending the Telecom Tax, understandably refuses to make.

IV. Section 171 of the Kentucky Constitution, and the Equal Protection Clause of the Federal Constitution, Do Not Have a Role in this Case.

KCTA (and, again, not the Cabinet) contends that, if any part or all of the Telecom Tax is struck down, it purportedly will violate the Uniformity and Equal Protection Clauses of the Kentucky and United States Constitutions. KCTA knows that this argument is a red herring as its brief does not develop the argument beyond discussing an irrelevant 2004 circuit court decision that is not binding on this Court. (*See* KCTA Br. at 22-24 (citing *Insight Ky. Partners II, L.P. v. Comm.*, No. 1-CI-01528

(Franklin Cir. Ct. Jan. 30, 2004))).[18]

In *Insight Kentucky Partners*, Insight, a cable television company, challenged KRS § 136.120, which imposed a public service corporation property tax on cable television companies. Insight claimed that this property tax assessment violated § 171 of the Kentucky Constitution (which requires that taxes "be uniform upon all property of the same class") and the equal protection principles in the Kentucky and federal constitutions because it did not apply to satellite television providers. Instead, satellite providers were assessed property taxes under a different statute, which Insight alleged was a less expensive property tax because, unlike KRS § 136.120, it did not include a tax on goodwill value. In response, the Revenue Cabinet argued that cable and satellite companies could be classified differently and, thus, taxed differently in compliance with § 171 and equal protection principles.

The circuit court held that KRS § 136.120 violated § 171 and did not address the equal protection arguments. The court rejected the Revenue Cabinet's assertion that cable and satellite companies should be classified differently for purposes of the property tax at issue and § 171, and explained that "constitutional provisions permitting classification *always* carry with them the limitation that the classification scheme must be *reasonable*, not *arbitrary*, and this in turn requires classification on the basis of an appreciable relevancy to the subject matter of the legislation." Opinion and Order at 4, *Insight Kentucky Partners*, Civil Action No. 01-CI-01528 (internal quotation marks omitted) (quoting *Gillis v. Yount*, 748 S.W.2d 357, 363 (Ky. 1988)). The parties agreed that the "subject matter" of § 136.120 was to raise revenue, but the circuit court found no

[18] KCTA attached this decision to its brief at Exhibit 7. It is not appended hereto.

reasonable basis for classifying cable and satellite companies differently for this purpose.

The court did not dispute that differences exist between cable and satellite providers, but merely concluded that the differences were irrelevant to and thus should not impact *state property taxation* as they offered no basis for taxing the goodwill of one company and not the other. The court concluded, "[s]ince no substantial distinction exists between cable and [satellite] companies for the purpose of raising revenue, the Court holds that applying KRS 136.120 to cable companies and not [satellite] companies is arbitrary and violates section 171's uniformity requirement." *Id.* at 8.

In reaching its ruling, the circuit court carefully emphasized that its decision was limited to the assessment of *property taxes* on cable and satellite companies. In other words, the court did not address whether cities' assessment and collection of *franchise fees* on cable companies violated § 171. The court's Opinion and Order referred throughout only to *property taxes* on cable and satellite companies, which are levied to raise revenue, but did not mention franchise fees on cable companies, which are collected to compensate a city for the use of its streets and rights-of-way. Thus, *Insight Kentucky Partners* is inapplicable here.

Not only did *Insight Kentucky Partners* not address the assessment and collection of franchise fees, but the arguments made in that case do not apply to franchise fees because § 171 only restricts the assessment of property and license or occupation taxes. *See Great Atlantic & Pacific Tea Co. v. Kentucky Tax Commission*, 128 S.W.2d 581, 588 (Ky. 1939) ("While provisions of Section 171 of our Constitution, requiring taxes to be equal and uniform, apply in their fullness only to direct taxation of property, yet [sic] the principle of equality and uniformity must be observed in imposing license and occupation

taxes."). As explained above, franchise fees assessed and collected under §§ 163 and 164 are not equivalent to license fees or taxes. Section 171 has not been applied to franchise fees collected under §§ 163 and 164.

Finally, even if this Court believes that § 171 does apply to the assessment and collection of franchise fees on cable providers under §§ 163 and 164, § 171 is not violated when franchise fees are levied on cable companies but not satellite companies. As an initial matter, the Cities seek only the invalidation of those portions of the Telecom Tax that prevent cities from collecting franchise fees that they are entitled to under §§ 163 and 164. If this Court grants this relief, it will not have the effect of enacting or imposing any additional tax that destroys uniformity and, thus, offends § 171. Instead, the Court merely will enforce constitutional provisions already in effect. This would not present the type of scenario to which § 171 normally applies. An equal protection and/or uniformity challenge typically is taken to argue that *a law has been enacted* that does not treat similarly situated persons alike. *See, e.g., Vision Mining Inc. v. Gardner*, 364 S.W.3d 455, 465-66 (Ky. 2011; Ky. Const. § 171. The Cities neither enacted the Telecom Tax, nor have they done anything to classify any person (including KCTA or its members) differently or to discriminate against anyone based on a classification. The Cities merely assert their own constitutional rights, which the Telecom Tax wrongfully strips from them.

Moreover, the imposition of franchise fees on cable companies (and not on satellite companies) does not violate § 171 because these companies should be classified differently in regard to franchise fees. The purpose of the assessment and collection of franchise fees under §§ 163 and 164 is to provide cities with compensation for the use of

public streets and rights-of-way that utilities access to conduct business. *See, e.g., Berea College Utils.*, 691 S.W.2d at 236. This purpose clearly is connected to one of the primary differences between cable and satellite companies—that one requires access to a cities' streets and rights-of-way and the other does not—and, thus, provides a reasonable basis for classifying those companies differently for purposes of § 171. *See, e.g., Directv, Inc. v. Treesh*, 487 F.3d 471, 473-74 (6th Cir. 2007) (describing the differences between cable and satellite companies). Accordingly, equal protection and uniformity arguments cannot be invoked to challenge the Cities' position.

V. Affirming the Court of Appeals' Opinion Will Not Create Confusion or Uncertainty, Nor Would That Be a Legitimate Reason to Uphold an Unconstitutional Statute.

Appellants and Charter raise concerns about what will occur if this Court affirms the Court of Appeals' decision. Their concerns are both ill-founded and irrelevant to whether the Telecom Tax violates the constitutional rights of Kentucky cities. Kentucky courts must enforce the law of this Commonwealth, the most supreme of which is the Kentucky Constitution. The Court of Appeals did exactly this.

A. The Telecom Tax is unconstitutional to the extent it violates §§ 163 and 164 of the Kentucky Constitution, and voiding specific language in the Telecom Tax will not unduly impair the entire scheme.

The Cities do not argue that the entire Telecom Tax is unconstitutional, nor did the Court of Appeals hold as much. Rather, as the Cities requested, the Court of Appeals declared the Telecom Tax void only as applied to cities and to the extent it violates § 163 and § 164 by forbidding cities from levying and collecting franchise fees. Appellants and

Charter, however, wrongly state that the Court of Appeals declared the entire Telecom Tax unconstitutional. (Cab. Br. at 12; KCTA Br. at 11 n.7, 23 n.12; Charter Br. at 7).

The Court of Appeals explained that the Cities' petition for declaratory relief "argued that the Telecom Tax violated Kentucky Constitution Sections 163 and 164" which "delegated to local government the right to grant franchises and collect franchise fees therefrom." (Opinion at 4). In other words, the court recognized that the Cities did not argue that the Telecom Tax is unconstitutional in full. Thus, the court identified one "question of law" on appeal: "whether the Telecom Tax violates Kentucky Constitution Sections 163 and 164." *Id.* at 5. From that point, the Court of Appeals addressed only how the Telecom Tax violates § 163 and § 164 as applied to Kentucky's cities, and not the constitutionality of the entire tax scheme, and concluded that the Telecom Tax "violates Kentucky Constitution Sections 163 and 164 by prohibiting [the Cities] from assessing and collecting franchise fees." *Id.* This narrow ruling should be upheld.

The "surgical" invalidation of the Telecom Tax to the extent it violates §§ 163 and 164 will not cause the problems that Charter imagines. (Charter Br. at 1-3, 6-8).[19] If this Court affirms the decision below, the Commonwealth will be barred from preventing Kentucky's cities from levying and collecting franchise fees. Under KRS § 446.090, nonessential and separable portions of a statute can be invalidated without requiring the

[19] For example, Charter expresses concern about whether a ruling in the Cities' favor would have retroactive application and then, using scare tactics, raises hypothetical questions and makes dire predictions based on this concern. (Charter Br. at 2-3, 7-8). But the Cities never have sought retroactive relief in this case, and it is only as to them that the Telecom Tax is unconstitutional. In fact, at no point in this suit before KCTA asked the Court of Appeals to modify its Opinion did any party put in issue whether a declaration of unconstitutionality would be retroactive. There also is no language in the Opinion that would suggest it should apply retroactively. Charter is inventing a problem where none exists.

invalidation of the full statute, and the offending provisions of the Telecom Tax can be properly severed from the remainder of the scheme. A provision is nonessential "where [it] may be eliminated and the remainder given effect without interfering with the just and proper working out of the general purposes of the act." 16A Am. Jur. 2d *Constitutional Law*, § 209 (2012). Further, "[w]henever a statute contains unobjectionable provisions separable from those found to be unconstitutional, it is the duty of the court so to declare and to maintain the act insofar as it is valid. In that situation, a court should refrain from invalidating more of a statute than is necessary." *Id.* at § 199.

The overarching purposes of streamlining the taxation of the telecommunications industry and leveling the playing field still can occur without a prohibition against the cities' collection of franchise fees. If the provisions offending §§ 163 and 164 are invalidated, the Commonwealth still will be able to collect the Telecom Tax as only the cities will no longer be required to participate in the Telecom Tax scheme. *See* Ky. Rev. Stat. §§ 136.650(1)(a), 136.660(4). The remaining political subdivisions, school districts, and special districts not protected by §§ 163 and 164 still will be required to participate. Meanwhile, cities will be able to enforce their franchise agreements—and enter into new franchise agreements—and collect franchise fees. In essence, once the provisions preventing them from doing so are excised, cities would essentially "opt out" of the Telecom Tax (as the Cabinet has suggested) and the rest of the tax scheme can continue without their participation.

Cable and communications companies will not be subject to double-taxation as KRS § 136.660(4) and (5) still will be in effect, forbidding a city that imposes a franchise fee from receiving proceeds from the Telecom Tax and providing companies that pay a

franchise fee with a credit against the amount they are required to pay to the Commonwealth under the Telecom Tax. This will not unreasonably burden companies required to pay franchise fees as they only will have to pay those cities with which they have a franchise agreement that requires the payment of franchise fees, and the tax they pay to the Commonwealth will be offset by the franchise fees that they pay. There will be no Hobson's choice for providers or cities; rather, they can proceed as they did *for decades* prior to the Telecom Tax and providers will continue to follow those provisions of the tax scheme that do not violate the Cities' constitutional rights.

Further, although federal law prohibits localities from collecting franchise fees from satellite companies, the Commonwealth will continue to collect the Telecom Tax from satellite companies if the Telecom Tax is invalidated using the Cities' suggested approach. Thus, the Telecom Tax also will persist in its purpose of alleviating the inequities and unfairness created by federal legislation. *See* Ky. Rev. Stat. § 136.600(2).

B. The possible impact of declaring the Telecom Tax unconstitutional as applied to Kentucky cities is irrelevant to whether the Telecom Tax violates the constitutional rights of Kentucky cities.

Charter offers much speculation about what may happen if this Court rules in the Cities' favor. (Charter Br. at 2, 6-8). But courts do not avoid making difficult decisions because of their potential effects. Indeed, this Court has issued momentous decisions affecting the Commonwealth profoundly in the past, and did not refrain from doing so because the results would be wide-spread.

For example, in 1989, this Court declared education to be a fundamental right in Kentucky, and held that "Kentucky's entire system of common schools is unconstitutional." *Rose v. Council for Better Educ.*, 790 S.W.2d 186 (Ky. 1989). The decision led the General Assembly to pass the Kentucky Education Reform Act of 1990,

"which radically changed the system of public education in this Commonwealth." *Chapman v. Gorman*, 839 S.W.2d 232, 234 (Ky. 1992). This Court did not avoid issuing a watershed decision recognizing constitutional rights because it would have a significant impact on the Commonwealth's entire system of public schools and the state's coffers. A ruling for the Cities in this case will not have nearly the same effects.

Kentucky courts also will declare Kentucky tax schemes unconstitutional. For example, in the mid-1990s, this Court struck down two of Kentucky's long-standing intangibles taxes. *See St. Ledger v. Ky. Rev. Cab.*, 912 S.W.2d 34 (Ky. 1995), *vacated and remanded*, 517 U.S 1206 (1996), *on remand*, 942 S.W.2d 893 (Ky.), *cert. dismissed*, 521 U.S. 1146 (1997). In the *St. Ledger* series of cases, this Court addressed challenges to Ky. Rev. Stat. § 132.030 (taxing out-of-state bank deposits at a higher rate than in-state deposits) and Ky. Rev. Stat. § 136.030(1) (exempting from taxation the stock of corporations that paid taxes to the state on at least seventy-five percent of their total property). The Court found that, while the Revenue Cabinet tried to justify both taxes, they unlawfully restricted interstate commerce. As a result, this Court ordered that taxpayers were entitled to a refund of the unconstitutional taxes, and the decision impacted Kentucky citizens, banks, corporations, and the state's coffers.

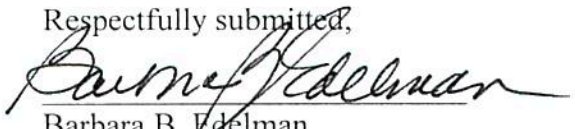
In contrast to the rebuilding of Kentucky's entire public school system and the invalidation of truly longstanding tax schemes, a decision in the Cities' favor here will not result in a controversial outcome. Instead, it will allow Kentucky cities and some public utility companies to return to a franchising system that has applied in the Commonwealth for over 100 years. Moreover, Charter's unfounded theories about what could arise if this Court upholds the Cities' rights cannot overcome the bedrock

requirement that Kentucky courts must strike down laws that violate the Kentucky Constitution. *See* Ky. Const. § 26. None of Charter's hypothetical concerns justify denying the Cities their constitutional rights. This Court's prior decisions reflect that the Court will fulfill its obligation to protect constitutional rights even when doing so will impact the Commonwealth.

CONCLUSION

As the Telecom Tax violates the Kentucky Constitution, the Court of Appeals' decision should be AFFIRMED and the offending portions of the Telecom Tax that infringe on cities' right to levy and collect franchise fees should be stricken. The Cities ask that the Court strike down § 136.650(1)(b)(2) (requiring political subdivisions to relinquish their right to franchise fees) and § 136.660(1) (expressly prohibiting political subdivisions from collecting franchise fees). This will leave the Telecom Tax largely intact, only invalidating those portions that violate §§ 163 and 164 of the Kentucky Constitution as applied to Kentucky cities.

Respectfully submitted,



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